Subcommittee hearings

Senate warned new tax law will harm private pensions

By Joel Chernoff

WASHINGTON—The 1982 tax law would cause termination or curtailment of more than 900 of the 1,700 member plans of the South Florida Employee Benefits Council, a Senate subcommittee hearing was warned early this month.

Charles P. Sacher, the council's past president, testified that figures show the pension provisions contained in the Tax Equity and Fiscal Responsibility Act of 1982 would harm the private pension system.

He warned the impact of the law would be to cut benefits for workers and greatly reduce the amount of capital available for investment.

Meanwhile, Sen. John Chafee, R-R.I., chairman of the Senate Finance Subcommittee on Pensions, Savings and Investment Policy, asked several witnesses why retirement plans should provide loans to participants. His repeated questioning led observers to believe the senator would mount an attack against such provisions.

The 1,700 plans sponsored by council members cover 32,500 participants and collectively have $500 million in assets. They are mostly small plans that will fall subject to the tax law's so-called "top-heavy" provisions, which provide faster vesting, minimum benefit levels and other requirements on plans where key executives receive 60% or more of plan benefits (*Pensions & Investment Age*, Aug. 30, 1982).

In a letter to Sen. Bob Dole, R-Kan., Mr. Sacher said the "annual contributions to these plans will be reduced by more than $40,000,000 resulting in a reduction in funds" available for mortgage investments, stock purchases, corporate bonds and home construction.

In addition, he testified the burden would be shifted to the Social Security system in the long run.

If such a dramatic turn of events comes about, it could cause Congress to re-examine the private pension plans to see if they provide adequate pension coverage for workers.

Other than the South Florida council, no groups that testified before Sen. Chafee's subcommittee had similar numbers to show.

Sylvester J. Schieber, research director for the Employee Benefit Research Institute, a non-profit think tank on benefits, said that data would not be available until the end of the year at best.

Many speakers objected to the onerous requirements imposed by the law's new rules on "top-heavy" plans.

In particular, small-business representatives argued the provisions singled them out for no good reason. "The top-heavy rules stand out as a blatant, discriminatory attack on small businesses and their owners," said Stephen H. Paley, a member of the Small Business

Continued on page 34

AT&T response to objections says asset allocation is fair

By Joel Chernoff

WASHINGTON—American Telephone & Telegraph Co. says the method used to allocate $45 billion in pension assets as part of the trust restructuring was picked to best protect the interests of employees.

The statement was made in a March 15 response to objections on the restructuring filed by the State of Maine and its Public Utilities Commission.

In its response, AT&T said Maine's proposed method, which would cause as much as an additional $2 billion in assets to be allocated to the pension funds of the new seven regional operating companies, would violate AT&T's fiduciary responsibility.

The telecommunications giant also rebutted claims by the Communications Workers of America, which represents 500,000 AT&T workers, that the restructuring of the fund must be subject to collective bargaining.

AT&T wrote, "such a claim is not supported by the case law, nor by the prior conduct of the parties."

The restructuring of the trust is spelled out in AT&T's reorganization plan, which was adopted to settle an antitrust battle with the Justice Department (*Pensions & Investment Age*, Dec. 20).

The trust holds assets from two pension plans, one for management and one for hourly workers. Under the reorganization proposal, the pension plans would be spun off into 18 plans—one management and one hourly plan each for AT&T, the seven regional operating companies and a central services organization.

The last would be owned jointly by the regional companies and would provide them network planning, computer software development and other functions. However, it is not yet decided whether there will be a separate pension trust for the subsidiary.

AT&T's savings plans for management and hourly employees would be broken up on a similar

Continued on page 33

International issue

Pensions & Investment Age has mailed out questionnaires for its annual directory of international investment advisers.

The survey, appearing May 30, details statistical and general information for each firm, including total and tax-exempt assets under management, number of U.S. tax-exempt clients, asset mix, investment philosophy and client contact.

The International Investment Adviser Directory Issue is used by many pension funds as a starting point in their search for international managers, and also is a source for industry statistics.

Any international firm that wishes to be included in the directory but has not received a questionnaire should contact *P&I Age* editor **Mike Cleves, at (212) 210-0121.**

Deadline: April 25, 1983

Late news

Continued from page 1

ment board for $34.5 million from the county employees' retirement system in an attempt to bail themselves out of a budget deficit by using the so-called "surplus" funds. No immediate response was available from the retirement system.

The county also has settled out of court its suit against the Wall Street firm of Donaldson, Lufkin & Jenrette Inc. The suit the county filed last year claimed the securities firm had made unauthorized transactions; the firm countersued, contending the transactions had been authorized.

Under the settlement, Los Angeles County will reimburse Donaldson, Lufkin & Jenrette $11.2 million of $13.5 million the county had drawn on a credit line provided by the brokerage firm.

Peoples Energy hires

CHICAGO—Peoples Energy Corp. has reallocated the equity portion of its $270 million pension plan after a change in its performance goals and objectives, according to Donald G. Holm, vice president, treasurer and secretary. The fund is split evenly between equities and fixed income.

Peoples Energy named Atalanta Capital Corp., Stein Roe & Farnham and Wall, Patterson, McGrew & Hamilton Inc. as new equity managers, with roughly $30 million allocated to each. Mathers & Co. Inc. was the only equity manager retained.

Value Line changes

NEW YORK—Dorothy Berry, president of Arnold Bernhard & Co. and Value Line Inc., will be leaving the firm at the end of April, sources said.

According to a Value Line preliminary prospectus, Arnold Bernhard, chairman of both companies and president until December 1979 when Ms. Berry took over, will resume the duties of president May 1.

NYC plan starts fund

NEW YORK—New York City's $7 billion Teachers Retirement System appointed Metropolitan Life Insurance Co. in March to run a newly formed variable B fund, according to Wally Sullivan, executive director. On July 1, Metropolitan Life will offer a guaranteed investment contract paying a minimum 11¼% rate of return for one year, said Claude Lamoureux, vice president-group pensions.

Specialist exits Freres

NEW YORK—Hakan Castegren, a foreign securities specialist at Lazard Freres & Co., has left to join Grantham, Mayo, Van Otterloo & Co., Boston, a spokesman confirmed. Mr. Castegren provided international portfolio management for Lazard Freres' $1.8 billion tax-exempt assets. No replacement was named.

Ryan to leave DOL

WASHINGTON—T. Timothy Ryan Jr. will leave his post as solicitor of labor May 1, reportedly to return to the law firm of Pierson, Ball & Dowd. Mr. Ryan has been the Labor Department's top lawyer for the past two years.

Separately, the department is reviewing whether to bring suit against 22 Southern California construction union pension funds that bought $158 million in commercial and home mortgages for projects on which union members have worked (*Pensions & Investment Age*, Nov. 22).

In addition, the Labor Department has sued trustees of the Northern New England Carpenters Fund for making loans at below-market interest rates that helped employers affiliated with the plan.

New international fund

TACOMA, Wash.—Frank Russell Trust Co. has named Baring International Investment Ltd., London, Daiwa International Capital Management Corp., and Nomura Investment Management Inc. to run a new international investment fund focusing on the Pacific rim. The International II Fund, which became operational April 1 with $15 million, was constructed at the request of Boeing Corp., the first client.

Bankers units merge

NEW YORK—Bankers Trust Co. has merged its research and equity portfolio managers in the investment management group into one team, according to H. Kent Atkins, senior vice president.

The move is effective immediately and marks the first step toward implementing the previously announced reorganization of Bankers' trust department into two distinct areas—one for the administration of employee benefit funds and another for the investment management of those funds, (*Pensions & Investment Age*, Jan. 24).

Mr. Atkins denied the move was a defensive reaction to the departure of John Schroder, senior vice chairman and chairman of the investment committee, to E.W. Axe & Co.

Mr. Schroeder joins E.W. Axe this month as chairman of the board and chief executive officer.

Highlights

CASH MANAGEMENT Page

Shutting the door on embezzlement 23
Chemical redeploys staff for electronic age 23
Check costs set to rise again 23

DAN DORFMAN

Oil companies' balance sheets deteriorate 8

FEATURES

Leuthold: Ballpark analysis 20
Wubbels: Questions on p/e ratios 21

FINANCIAL SERVICES

Treasurers review the changes 12

GENERAL NEWS

Advisers outperform the indices 4
Consulting firm formed 6
Annual reports detail interest assumptions 9
Energy-firm equity fund launched 26

INTERNATIONAL INVESTMENTS

International investment rebounds 17
Doubts cloud British real estate claims 17
International marriage boosts Boston firm 18

OTHER DEPARTMENTS

Corrections 4
Datebook 29
Editorial 10
Letters 10
Money movers 38
People 30
Washington 28

Vol. 11, No. 8—Pensions & Investment Age (ISSN 0273-5466) is published every other Monday at 740 Rush St., Chicago, Ill. 60611. Second class postage paid at Chicago, Ill. and at additional mailing offices. Postmaster: Send address changes to Pensions & Investment Age, Circulation Dept. 740 Rush St., Chicago, Ill. 60611. Copyright 1983.

Contract law imposed

Pensions aren't gifts, Minnesota court rules

By Linda Savage Ruhe

MINNEAPOLIS—Public pensions are protectable entitlements that cannot be taken from employees, according to a Minnesota Supreme Court ruling.

The court held pensions no longer are gifts from the state and cannot be withdrawn, although they are subject to reasonable legislative modification.

Many Minnesota attorneys have labeled this a landmark decision that could have an impact on public as well as private pension systems across the country, according to Daniel W. Lass, Minneapolis Employees Retirement Fund assistant executive director and legal counsel. The court ruling, however, is binding only on Minnesota public plans.

The decision makes it more difficult for the Legislature to make changes in the pension laws, according to Mr. Lass. However, it does leave the Legislature with the right to make reasonable changes within the law, including those that would retain the fiscal integrity of

Continued on page 34

Fixed-income rises

Recession pushes unions into conservative investing

By Nancy Webman

DALLAS—Taft-Hartley pension funds are being hit squarely in the pocketbook by the recession-created unemployment plaguing several industries.

And in response, union funds are moving toward more conservative pension fund investments—at a time when other funds are moving more into equities to take advantage of the recent market surge.

Unemployment is the culprit, according to Ed Burke, a consultant with A.G. Becker Inc. The lower number of union workers on the payroll has caused contributions to decrease without a corresponding decrease in benefit payments.

Mr. Burke, who specializes in working with public and union pension funds, said the latter have become more invested in fixed-income and short-term vehicles as contributions have declined.

"They ran scared; they wanted to stay more liquid," Mr. Burke said. "They're more scared, and they think equities are risky, yet they're still doing well in equities. They've just gotten more conservative."

He cited Becker statistics on the percentage of union pension assets invested in equities. Six years ago, he said, 43.2% of the assets were allocated to equities. As of Dec. 31, 1982, that number had dropped to 34.3%.

The reduction in equity exposure is significant because it came at a time when the stock market was soaring to new highs. And it was not an indication of how equity portfolios in union pension funds had performed because, for the past five years, union equity portfolios consistently outperformed the Standard & Poor's 500 stock index, Mr. Burke said. In 1982, for example, the portfolios beat the S&P 500 by almost four percentage points, he said.

Randy Barber, a union pension consultant, agreed with Mr. Burke's assessment.

"These funds depend upon levels of employment. To the extent that employment goes down, these funds are in worse shape," he said.

But Mr. Barber said he believes most Taft-Hartley funds will not have to alter their investment approach significantly because the reduced contributions are a "blip, not a permanent problem."

"We're looking at a cyclical, not a secular, decline, and pension funds are looking down the road at a 20- or 30-year funding period," he explained.

Several other consultants as well as union pension officers and investment managers concurred. "Liabilities are not significantly altered," said Sandy Lincoln of A.S. Hansen Inc.. "There has been reduced employment in industry groups and reduced contributions. But, simultaneously, there has been

Continued on page 38

Advisers bullish on bull market

Counselors say it's here to stay

By Pavan Sehgal

NEW YORK—Investment advisers at brokerage firms are steadfast in their belief that the bull market is here to stay.

And hibernating bears ought to be in for a long sleep if the theories of portfolio strategists at the investment houses prove right.

The bullish sentiments:

- We are in, maybe, a two- to three-year bull market, according to Suresh L. Bhirud, vice president and portfolio strategist at The First Boston Corp. "Within that time frame, stocks could go as high as 2,000 on the Dow Jones Industrial Average," he said.
- The current bull market is very similar to those of 1971 and 1975, said Hugh A. Johnson Jr., head of the investment policy committee at the First Albany Corp. "The market will correct modestly, just as it did in the summer of 1971 and just as it did in the summer of 1975," he added. He expects the market has an additional 17% to 20% appreciation to go, lasting well into 1984.
- The long-term outlook for the financial assets market is quite positive, according to Alan D. Schwartz, general partner and director of research at Bear Stearns & Co. "That's a function of my belief that a deregulated interest rate market will maintain a degree of discipline over monetrary policy," he explained. "Emanating from that will be a trend of continued moderate inflation, declining interest rates, and an improving or more stable economic growth environment."

Continued on page 37

'Thinking small' costs more in investment adviser fees

By Kimberly Blanton

CHICAGO—Smaller investment counseling firms charge twice as much in management fees as their larger bank and trust company counterparts.

And those fees may be increasing: Consultants assert the bull financial markets have laid the groundwork for fee hikes, a trend emerging among a few of the firms surveyed.

According to a survey by A.G. Becker Paribas Inc.'s Funds Evaluation Division, the median fees range from 23 basis points for large banks to 63 basis points for small investment counseling firms for equity management; from 23 points to 62 points for balanced management; and from 21 points to 45 points for fixed-income management for account sizes ranging from $10 million to $50 million. Client and manager often negotiate fees when the account size crosses the $50 million mark.

A.G. Becker compiles these figures and others semi-annually from surveys of more than 100 investment counselors and banks. In the survey of fees at the end of 1982, managers are divided into four categories: small investment counseling firms managing less than $1 billion; large counseling firms managing more than $1 billion; small banks and trust companies managing less than $3 billion; and large banks and trust companies. (*See table at right*).

The sharpest contrast between the median fees of large banks and small managers occurs in equity management.

The median fee for the management of a $25 million account at a small investment counseling firm is 54 basis points, or 0.54% of the dollar size of the account, compared with 0.26% at a large bank or trust company. This translates to a $70,000 difference on a $25 million account.

The median small bank or trust company managing the same account charges 0.33%, and a large investment counselor charges 0.50%.

All firms' fees for balanced management, in which the manager decides the portion of a client's assets to invest in equities, cash and bonds, closely match their straight equity fees in all account sizes and all quartiles.

Fees for fixed-income investments consistently are lower than equity fees among all firms, account sizes and quartiles. Consultants suggested that, unlike equity management, investment firms purchase much of their interest-rate and bond research from Wall Street firms, and base investment judgment on it.

However, the difference between fixed-income and equity fees is greater among counselors than banks.

Most consultants assert the returns the different firms produce do not explain the wide variation in fees

The median fee for managing a $50 million fixed-income account is 0.21% at a large bank, compared with 0.23% for a $50 million equity account there. At a large investment firm, a $50 million fixed-income account fee is 0.30%, compared with 0.43% for a stock account.

"There has been a decided trend toward higher fees, if you look at the new investment counseling firms," explained Sandy Lincoln, director of investment services at A.S. Hansen Inc., Chicago.

However, most consultants assert the returns the different firms produce do not explain the wide variation in fees.

"The product being sold is an intangible investment product," explained Roger Smith, executive vice president, Greenwich Research Associates Inc.

Mr. Smith suggested investment counselors typically charge higher fees because they "front stronger investment professionals" to potential clients. "It's just a perceptual difference rather than a real difference."

"I don't believe there's a correlation between return and fees," concurred Paul Berg of Berg Fiduciary Consultants Inc., New York.

He suggested pressure from the commercial loan side of banking has kept those fees from rising to equal counselors' fees. A bank's investment division meets "resistance when the commercial side gets a complaint (from a corporate client) about fees being raised," Mr. Berg explained.

"The trust department is viewed as an ancillary to the main business of the bank," he added. "That's another reason banks will negotiate fees when it comes to large (accounts)."

Consultants predict, however, that the fee difference between banks and counselors might narrow. "Banks have been slower to raise their fees, but they have been raising fees," Mr. Smith said.

And Mr. Berg predicts more will do so. "Banks again are talking about spinning out their investment departments, with a separate and distinct name," which brings higher fees, he said.

BA Investment Management Corp., which broke away from the Bank of America, has higher fees than AmeriTrust Co., Detroit Bank and Trust, and First National Bank of Atlanta, according to data collected by *Pensions and Investment Age*. BAIMCO's fees are 50 basis points on the first $20 million; 40 points on the next $10 million; 30 points on the next $10 million; and 25 points on the remainder.

AmeriTrust's fees are lower: 75 basis points on the first $2 million; 50 points on the next $8 million; 30 points on the next $15 million; 25 points on the next $75 million; and 20 points on the rest. Detroit Bank and Trust and First of Atlanta simi-

Continued on page 35

Investment management fees

(in basis points)*

Large counselors

(more than $1 billion under management)

	BALANCED Fund size ($ millions)			EQUITY Fund size ($ millions)			FIXED Fund size ($ millions)		
	$10	$25	$50	$10	$25	$50	$10	$25	$50
Highest	100	100	90	100	100	90	50	50	44
25th quartile	75	61	54	75	60	53	45	38	34
Median	58	50	43	58	50	43	38	34	30
75th quartile	49	40	35	50	41	36	30	26	24
Lowest	41	30	23	41	30	23	20	19	17

Small counselors

(less than $1 billion)

Highest	100	95	85	100	95	85	55	52	51
25th quartile	75	60	55	75	64	56	50	44	41
Median	62	52	42	63	54	43	45	36	32
75th quartile	54	43	34	55	44	36	28	27	22
Lowest	45	33	23	45	33	23	23	19	15

Large banks and trust companies

(more than $3 billion)

Highest	60	52	46	60	52	46	44	35	34
25th quartile	50	46	38	50	46	38	36	27	25
Median	37	26	23	37	26	23	34	25	21
75th quartile	32	22	17	32	22	17	29	22	17
Lowest	25	18	14	25	18	14	25	18	14

Small banks and trust companies

(less than $3 billion)

Highest	65	65	65	65	65	65	53	42	41
25th quartile	50	40	35	50	42	35	43	34	30
Median	43	33	28	43	33	28	36	29	24
75th quartile	34	27	22	34	27	22	31	25	21
Lowest	22	17	10	22	17	10	22	17	10

Source: A.G. Becker Paribas Inc.'s Funds Evaluation Division

*100 basis points equal one percentage point.

Features

Striking out with 'winners'

Sporting look shows some analysis not even in the ballpark

By Steve Leuthold

SECURITY analysts, economists and pension officers seem to have an intrinsic fascination with comparative ratios and performance measures of all kinds. And certainly the era of the computer has facilitated the generation of these measures.

The Leuthold Group's initial analysis of productivity several years ago enmeshed us in a virtual maze of industry-by-industry and company-by-company productivity (efficiency) comparisons. Many now view quantitative measures as the key to intelligent future judgment.

In the business of investing, the ultimate objective of all this statistical grinding is picking the right stocks. Now, to demonstrate the fallibility of some operating ratio and performance analysis, let us construct some comparisons with the great American pastime—baseball.

Data used in the calculations have been provided by Marvin Miller's Major League Baseball Player's Association and "Sporting News."

One way to isolate winning stocks in our business is to find the most efficient producers: Who gets the most output out of the least input. By that measure, here is how the major-league baseball teams rank, top and bottom quartile. The 1982 team salary levels are compared with 1982 output, calculating first the cost per run scored. Quartile designations in the tables are not entirely precise because the seven teams represent 26.9% of the total number of teams.

Clearly by this productivity measure, the Minnesota Twins was the best in both leagues, and the St. Louis Cardinals among the worst. Unfortunately, this measure has little to do with picking winners.

While most readers can quote today's Treasury bill rate, understandably, some might not be baseball fans. Therefore, it should be noted the Cardinals won the World Series in 1982, the California Angels won their division and the Twins had the worst record in baseball.

Sad to say then, this particular measure of comparative productivity is of little or no value in picking "winners," but does demonstrate anything can be proved with statistics.

Perhaps a more realistic measure of output is games won, not runs scored. Games won better reflects the pitching productivity factor in terms of measured output. Thus, in the following table, we calculate the cost per win ratio, with output measured in wins not runs. Thus, this might be viewed as a total factor productivity measure.

By this measure, Minnesota again has the best total productivity record, but unfortunately ended the 1982 season tied for last in its division. (However, Atlanta, also in the top quartile did actually finish first in the National League West.)

The two New York teams finished in the bottom quartile by this measure of relative productivity, but this can be explained by the horrid operating environment. After all, even the new West Side Highway—nicknamed WasteWay—will cost $2 billion or more per mile.

It was, however, surprising to find two Sun Belt teams, Houston and the California Angels, in the bottom quartile. After all, the Sun Belt environment is almost universally viewed as a significant positive productivity factor.

So far, this quantitative analysis has been an exercise in futility, at least in terms of picking winners. Unfortunately, our baseball experience mirrors the quantitative evaluation experience of many in picking winning stocks and picking winning managers based on past statistical analysis.

Are we on the wrong track? Perhaps output should not be measured in wins or runs, but in terms of how many tickets are sold. That's it. Baseball is not a game, it is a business.

The end product is tickets sold, not wins or runs. However, it is acknowledged wins and runs do at times have some effect on ticket sales.

Here, then, is our breakthrough analysis—the FIS ratio or the 1981 payroll cost per ticket sold in 1982. For those unfamiliar with the technical terminology used in the baseball business, FIS is an acronym for fannies in seats.

Even this calculation has some analytical limitations in that no adjustment is made for individual team variances in concession revenues, television contracts or the varying ticket price scales. Note also that the most recent team payroll statistics are for 1981 while attendance and won/lost statistics are for 1982.

True, measured in this way, none of the six best teams managed to win a divisional championship, but that is not the point. Wouldn't you have liked to own a piece of the Dodgers or Twins? Even the Blue Jays and the Padres were big scorers, although neither team managed to win more games than lost. Bottom line is the name of the game!

This report has been prepared from original sources and data we believe reliable, but we make no representations as to its accuracy or completeness.

The Leuthold Group, its affiliates and subsidiaries and/or their officers and employees might, from time to time, hold wagering positions relating to the teams mentioned herein.

However, even on request, we will not furnish specific information in this regard.

In the future, The Leuthold Group might act as principal for its own account or perhaps if the investment business gets tough enough, we could even act as agent.

As a footnote, the average salary of major-league baseball players in 1982 was more than $241,000, up 30% from the year before, up 68% from 1980 and 113% from 1979. The

Continued on next page

Steve Leuthold is chairman of The Leuthold Group, Minneapolis, which is associated with Lynch, Jones and Ryan, New York.

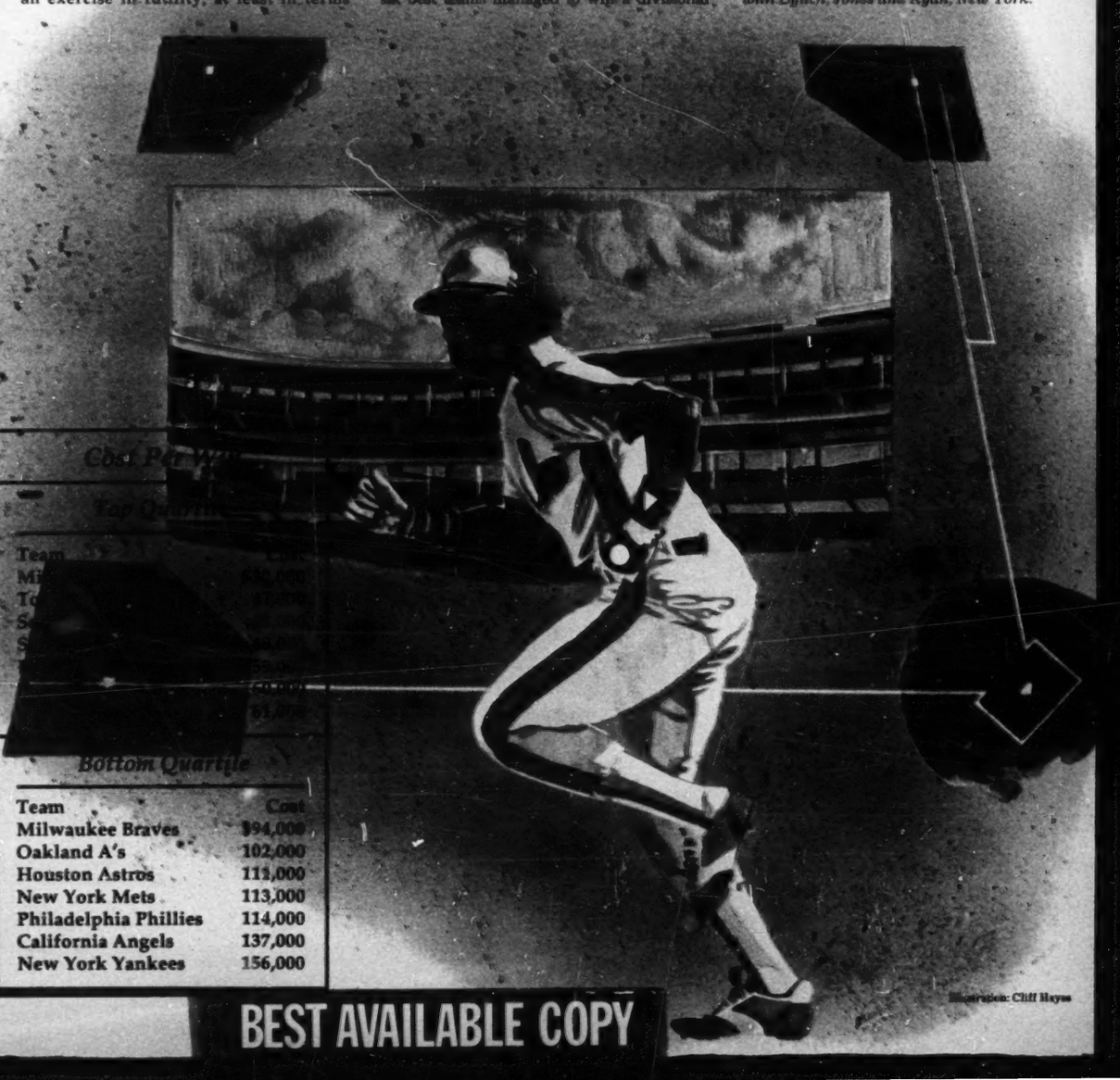


Illustration: Cliff Hayes

Cost Per Run Ratio

Top Quartile

Team	Cost
Minnesota Twins	$2,800
Toronto Blue Jays	4,900
Seattle Mariners	5,300
San Diego Padres	5,700
Detroit Tigers	6,700
Atlanta Braves	7,400
San Francisco Giants	8,000

Bottom Quartile

Team	Cost
Pittsburgh Pirates	$10,100
Montreal Expos	11,600
New York Mets	12,100
Houston Astros	15,100
Philadelphia Phillies	15,300
California Angels	15,600
New York Yankees	17,800

Cost Per Win Ratio

Top Quartile

Team	Cost
Minnesota Twins	$58,000
Toronto Blue Jays	61,000
Seattle Mariners	66,000
San Diego Padres	71,000
Detroit Tigers	83,000
Atlanta Braves	92,000
San Francisco Giants	99,000

Bottom Quartile

Team	Cost
Milwaukee Braves	$94,000
Oakland A's	102,000
Houston Astros	111,000
New York Mets	113,000
Philadelphia Phillies	114,000
California Angels	137,000
New York Yankees	156,000

BEST AVAILABLE COPY

Features

Shaking up a cornerstone?

Study raises questions on price-earnings ratio importance

By Alice C. Avanian and Rolf E. Wubbels

"Nil Credam et Omnia Cavebo"

THE LATIN proverb, meaning 'believe nothing and be on guard against everything,' might be a good credo for portfolio managers.

The results of a recent study we conducted raise serious doubts about one of the oldest and most basic beliefs of many on Wall Street—the importance of price-earnings ratios.

After six months of trying to prove there is a positive correlation between a company's earnings growth rate and its stock price-earnings ratio, it came as a surprise to us that the research didn't support the thesis.

For more than half a century, the keystone of fundamental security analysis has been that the price-earnings ratio both current and projected is a major determinant of stock prices.

Price-earnings ratios became a matter of broad professional and public interest when John J. Raskob was interviewed for an article titled "Everybody Ought To Be Rich," which appeared in the August 1929 edition of the "Ladies Home Journal."

Mr. Raskob was one of the nation's leading financiers in the 1920s and 1930s. He also was a director and chairman of the finance committee of General Motors Corp.; the person who conceived of and primarily financed the Empire State Building; and was prominent in political, church and charitable affairs.

In the interview, he stated a 15 price-earnings ratio was reasonable. His statement had an immediate effect on the market.

The academic community began to apply price-earnings ratios and present value analysis to stock prices.

Benjamin Graham, the generally acknowledged father of modern security analysis, stressed the significance of price-earnings ratios in the first edition of his text "Security Analysis," published in 1934 and in the numerous revisions that have appeared since.

Price-earnings ratios have been the focal point for virtually all efforts to evaluate securities.

It is difficult to picture a brokerage office where the sales staff is not interested in the research department's earning forecast or without a current copy of Standard & Poor's Earnings Forecasts. Each user utilizes his own assumed multiple to arrive at the projected stock price.

The price-earnings ratio might be considered the relative price paid for a stock. Prices paid for all stocks are the function of a myriad of factors, including market psychology and investors' perceptions of particular industry groups.

The assumption was made that the major factor establishing these relative price-earnings ratios are the company's perceived growth rate, which will be reflected in both earnings and dividends and whether the industry and company is in or out of favor with investors.

The study was very comprehensive in its attempt to prove that price-earnings ratios are highly correlated to the respective growth rate.

The methods used were traditional to Wall Street: quarterly data for stock prices and earnings reports, three-year average historic earnings growth and "prospective" earnings, (looking forward four quarters). The data was adjusted relative to the S&P 500 stock index, which is also common practice. Previous studies that attempted to show a relationship between price-earnings ratios and earnings growth used only year-end data or a limited number of companies.

The other technique used, which would differentiate the results from other studies, was the extensive use of screens through a customized computer program. After calculating the necessary growth rates, the program screened out companies that had negative growth. This was intended to reduce distortions from companies with temporarily high price-earnings ratios because of earnings disappointments. Companies with great "surprises" in earnings also were screened out.

The criteria for growth was 20% above the most recent average. This was done for two reasons. First, to remove the possibility of wide fluctuations in earnings that, if not totally and immediately reflected to the stock's price-earnings ratios, would distort the findings. Second, prospective earnings were used as a proxy for analysts' estimates, and growth that was well above average would strain the credibility of this substitute.

Both rank evaluations and regression analysis were employed using the quarterly Compustat Tape, and computations were run for 26 different quarters and for more than 2,000 companies. These included all listed stocks and all National Association of Securities Dealers Automated Quotations listed stocks. The screening procedure resulted in the exclusion of roughly half the available companies, with the main culprit being the requirement for no missing data.

This careful procedure resulted in proof of no significant relationship between the price-earnings ratio and the growth rates, both historic and future. In other words, a stock's current price-earnings ratio bears no relationship to either the company's recent or expected growth rate. Adjusting to the S&P 500 also proved inconsequential. As this defied the common-sense rules on Wall Street, a search was undertaken for the exceptions that would explain the rule.

First, it was assumed that too many companies' data were being aggregated. Despite the requirement for positive growth, a great disparity remained among the companies and the industries being considered. Also, using the entire Compustat file resulted in the inclusion of primary, secondary and tertiary companies. Much publicity has been given recently to the "inefficiency" of secondary and tertiary stocks, because of a lack of extensive research coverage on these stocks.

In order to factor out these problems of great agglomeration of data and market inefficiencies, statistical measures were run on smaller groups of stocks. Using Compustat's standard industry codes, the drug industry and the electronic computing group were tested.

Both groups are followed widely on Wall Street and can be considered relatively efficient. In addition, these are traditionally thought of as growth stocks and therefore should show the expected positive relationship between earnings growth and the price-earnings ratios.

Again, however, the results proved to be statistically insignificant.

This leads to the conclusion that, despite the original thesis and despite common usage on Wall Street, earnings growth rates are insufficient as a predictor of price-earnings ratios.

A possible explanation could be accounting differences, which result in differing perceptions of earnings and management and might affect stocks' price-earnings ratios multiples. Different investor attitudes toward industry groups also might have an effect. Possibly, Wall Street's use of growth rates might involve different definitions from the ones we used. In addition, recent articles have suggested the efficacy of correlating stock prices with cash flows and liquidity, rather than with "inflation-distorted earnings figures."

The efficacy of these factors (separate or combined) remains unknown. We must conclude, however, that our study has shown no significant relationship between stock price-earnings ratios and earnings per share growth (either historic averages or prospective 12-month figures). Despite the different methodologies used, this result agrees with previous studies done. Therefore, we conclude that earnings figures are an insufficient indicator of a stock's actual or expected price at any one point in time. ■

Alice C. Avanian, is vice president L.F. Rothschild, Unterberg Towbin, N.Y., and Rolf E. Wubbels is professor of finance at New York University.

Peter Manera, a research assistant at the Graduate School of Business, New York University, wrote the customized computer study used in this study.

Sporting look finds analysis striking out . . .

The "FIS" Ratio

	1982 Team Payroll	*1982 Attendance (in millions)*	*The FIS Ratio (Payroll dollars per ticket sold)*	*1982 Win-Loss Rank*
LA Dodgers	$5,840,964	3.61	1.62	9
Minnesota Twins	1,818,045	.92	1.98	26
San Diego Padres	3,862,488	1.61	2.40	15
Toronto Blue Jays	3,196,500	1.28	2.49	17
St. Louis Cardinals	5,938,325	2.11	2.81	4
Detroit Tigers	4,875,752	1.64	2.97	14
Atlanta Braves	5,446,792	1.80	3.03	8
Kansas City Royals	7,226,548	2.32	3.11	5
Seattle Mariners	3,432,150	1.07	3.21	20
Boston Red Sox	6,435,338	1.93	3.33	6
Montreal Expos	8,078,184	2.32	3.48	12
Baltimore Orioles	6,306,508	1.61	3.92	2
Oakland A's	6,924,710	1.74	3.98	22
Cincinnati Reds	5,291,832	1.33	3.98	25
Philadelphia Phillies	10,149,620	2.38	4.26	7
Chicago White Sox	6,687,171	1.57	4.26	11
Texas Rangers	5,033,448	1.15	4.38	24
Chicago Cubs	5,516,550	1.25	4.41	21
San Francisco Giants	5,357,826	1.20	4.46	10
Milwaukee Brewers	8,936,055	1.98	4.51	1
California Angels	12,702,090	2.81	4.52	3
Houston Astros	8,583,820	1.56	5.50	19
New York Mets	7,379,092	1.32	5.59	23
Cleveland Indians	5,832,000	1.04	5.61	18
New York Yankees	12,359,640	2.02	6.12	16
Pittsburgh Pirates	7,285,786	1.03	7.07	13

Continued from preceding page

31 players with 14 or more years in the big time averaged $500,000.

First basemen lead the position salary parade with the 20 first basemen playing in 100 or more games averaging $461,000. Based on this, maybe it's time for a portfolio manager-security analyst and pension officer union, one big "Investment Decision Makers Union."

Diverging interests some might say, but in union there is strength.

The Major League Baseball Player's Association supports sky-high salary levels by citing the relatively short employment term of athletes.

However, compared with the typical employment term of portfolio managers, security analysts and pension officers, athletes have the relative job security and longevity of civil service workers.

The ballplayers also have great additional benefits for career-ending disabilities. How about some bear market disability insurance for us? Spring training seminars in the Caribbean? Clothing and food allowances? Now, we even have to buy our own three-piece playing uniforms. Finally, all efficient market types and followers of Modern Portfolio Theory must be purged from our profession, blackballed as "scabs." Marvin Miller, where are you?

One final note of caution. A truly skilled collective bargaining leader is essential for any Investment Decision Makers Union that might be formed.

A strike must be avoided at all costs.

Our employers must never be allowed the opportunity to realize our real value in this whole investment ball game. ■

'Thinking small' costs . . .

Continued from page 3

larly have lower fee schedules than BAIMCO.

A comparison of A.G. Becker's June and December data show that since June, individual firms have raised the break-off point, which effectively raises fees, according to Dave O'Donovan, vice president and manager of A.G. Becker's manager search group. He stressed, however, these firms' fee hikes have not had a major impact on overall data.

And several consultants predicted managers' fine performance in last year's bull markets will spur fee hikes.

"People are not sensitive to fees when you're making a lot of money for them. I think you're going to see a lot of fees raised in the next six months to a year," Mr. Berg predicted. Raising the break-off point "is a very subtle way of building in a higher fee," he said.

Aside from the variation between bank and counseling firm, there are differences within the groups. In balanced and equity management, the largest and smallest counseling firms charge similar fees on a $50 million account, but smaller firms' fees rise more sharply as account size falls.

For the large counselors affiliated with mutual funds, the cost of their research is often covered by investment management for the firms' mutual fund, Mr. Berg said.

"Alliance Capital (Management Corp.) or Lehman (Management Co. Inc.) or Scudder (Stevens & Clark) can go after large public funds at 20 basis points because there's no incremental cost to them," Mr. Berg explained. Management fees they receive are "incremental income, frosting on the cake."

Small counselors, with small staffs, might be required to bring on another portfolio manager to handle a new account.

Median balanced and equity management fees for small and large banks do not converge; the smallest banks' fees are highest in all account sizes. Median equity fees among large banks are 0.37% for a $10 million account, 0.26% for a $25 million account and 0.23% for a $50 million account, against 0.43%, 0.33% and 0.28%, respectively, at small banks.

Mr. O'Donovan suggested large banks might charge lower fees for all account sizes because the large in-house research staff is used by many groups in the bank.

A firm's management style also affects its fee schedule. Mr. Berg stressed a distinction between core-index-fund or large-stock managers and "aggressive, very active managers."

"There's more sensitivity to fee schedules in the passive area in the perception of the plan sponsor," he explained.

This is apparent in a comparison of fees charge by American National Bank and Trust Co. of Chicago, where index funds constitute the bulk of the $4 billion under management, and Forstmann-Leff Associates Inc., known in the industry as an aggressive market timer.

Forstmann-Leff charges 100 basis points on the first $5 million, and 50 basis points on the remainder, according to *P&I Age* data. American National's fees drop sharply as the account grows: 50 basis points on the first $500,000, 20 basis points on the next $4.5 million, 10 basis points on the next $20 million, and it continues to fall.

Most consultants interviewed cast doubt on the importance of fees in choosing an investment manager. "Generally they are not very important, and if they do become important, firms will usually negotiate," explained Caroline Cummings, director of investment-management research for Meidinger Asset Planning Inc., echoing other consultants' views.

"If you have to go for major surgery, do you hire the (surgeon) that is cheapest," asked Mr. Smith of Greenwich Research. No, he said, "you go for the value."

Fees might be more important to government and unionized plans and corporate plans that pay them as an administrative expense instead of with investment assets.

"I personally don't think it is (important), but if somebody has to justify it on their budget that may be," said Mr. O'Donovan.

"Public funds are more sensitive," said Mr. Smith. "The fees are paid out of the operating budget, and it's subject to political opposition."

For the union plan, fees are a negotiating point in contract talks between labor and management, Mr. Berg asserted. ■

TCW directors open new firm

LOS ANGELES—Two managing directors of Trust Co. of the West, developers of a "liquidity index," have decided to open their own fixed-income investment counseling firm.

The two, Paul E. Anhalt and Michael F. O'Connell, also have been economic consultants to TCW since 1975.

When their contract with TCW was about to expire, they decided against merging with the trust firm and instead chose to go on their own, Mr. Anhalt said.

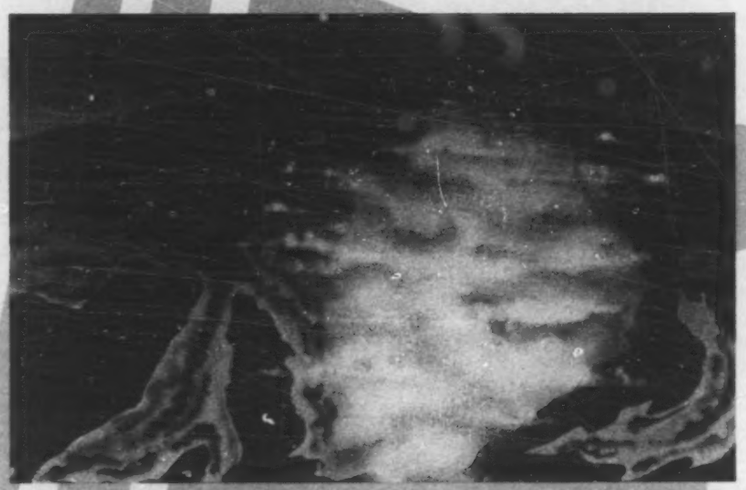
They will open a Los Angeles office in July.

Mr. Anhalt said the separation is "very amicable" and that TCW will help him and his partner keep clients for whom they had been managing fixed-income accounts utilizing the liquidity index. The liquidity cycle index is a system for forcasting secular and cyclical changes in interest rates.

Mr. Anhalt was one of the founders of TCW, but later sold his stock.

In 1975, he ended some of his relationships with TCW, but stayed, with his partner, as economic consultant to TCW. About 1981, they became portfolio managers using the liquidity index there. ■

© 1982 The Prudential Insurance Company of America, Newark, N.J.



NOW PRUDENTIAL CAN PUT THE WHOLE WORLD TO WORK FOR YOU WITH GLOBAL SECURITIES ACCOUNTS

Prudential has two words of advice for pension plan sponsors. Think Global.

Prudential believes that investing worldwide presents important opportunities. Not only an opportunity to increase a portfolio's rate of return, but a chance to reduce risk through added diversification.

For these reasons, we have been investing a portion of the company's general funds in foreign common stock and global bond portfolios. Last year, our foreign stock portfolio outperformed the S&P 500 and EAFE (Europe, Australia and Far East) indices. And, our global bond portfolio's return equaled the performance of the Salomon Brothers' market weighted Bond Index. Already Prudential is one of the larger investors in foreign securities worldwide. We are now ready to make our global investment services available to you.

How do we manage our global portfolios? For our foreign stock portfolio, our investment philosophy divides foreign portfolio management into two distinct phases. First, and most important, the selection and weighting of countries. Second, the selection and weighting of stocks within those countries. To help make these critical decisions, Prudential has devised an objective decision-making process and computer optimization model to effectively utilize a worldwide network of information sources.

This includes over 40 banks and brokers plus investment experts from the Bache Group, Inc., a wholly-owned subsidiary of Prudential, located in 15 countries around the world.

In managing our global bond account, we utilize our U.S. interest rate forecasting expertise in conjunction with a relative world bond market valuation model. In this way, we can capitalize upon the wide divergence between returns available in the eight international bond markets in which we invest.

If you would like to put the world to work for your portfolio, call or write Jim Gately, Vice President—Group Pension Department, Prudential Plaza, Newark, NJ 07101—(201) 877-3735.

Prudential

C2710-2
5/6/83

Pensions & Investment Age

© Entire contents copyright 1983 by Crain Communications Inc. All rights reserved. ®

The newspaper of corporate and institutional investing • $2.50 an issue • $52 a year • May 2, 1983

Cyclops suit claims misuse of fund assets

By Kimberly Blanton

PITTSBURGH—Cyclops Corp. has sued Texas businessman Harold C. Simmons, charging he is illegally using the pension funds of companies he controls to take control of Cyclops.

The suit claims Mr. Simmons broke securities law by failing to disclose what it claims are violations of the Employee Retirement Income Security Act in his alleged attempt to control Cyclops with several companies' pension plan assets for which he is trustee.

Mr. Simmons is either sole trustee or has sole power to invest the plan assets of the eight pension funds that are also named in the suit: the Keystone Consolidated Industries Inc. master pension and deferred incentive trusts; the Amalgamated Sugar Co. salaried and union employees' funds; the Gibson Products Co. profit-sharing plan; the T.I.M.E.-DC Inc. plan; and the Contran Corp. pension and profit-sharing plans. Accord-

Continued on page 33

Late news

Stock is contributed

BETHESDA, Md.—Martin Marietta Corp. announced it will make its third issue of stock to be placed in its pension fund in lieu of part of its 1983 contribution. The registration of 600,000 shares of common stock totals about $31.4 million at the stock's market price of about $52 per share.

This contribution brings the fund's holding in its employer's stock to $75.6 million, about 9% of the fund's assets, the company stated.

The firm made past contributions of 450,000 shares of common valued at $19.2 million in January for plan year 1983, and $25 million of preferred stock in December for the 1982 plan year.

The firm's 1982 pension expense was $77 million.

On Sept. 30, 1982, the Martin Marietta plan had $925 million in assets, according to *Pensions & Investment Age's* annual survey of pension funds.

Continued on page 2

Burroughs' lease-back

Firm sells 4 plants to own plan

By Kimberly Blanton

DETROIT—Burroughs Corp. has sold four light manufacturing facilities valued at about $30 million to its pension fund and is leasing them back for its own use.

The sale and lease-back enabled Burroughs to raise cash while retaining the use of the facilities, according to Leon J. Level, vice president and treasurer.

At the same time, he said, the pension fund has made a sound investment, a primary consideration in designing the transactions. The transactions took place in 1981 and 1982.

The $30 million investment is roughly 6.4% of Burroughs' $470 million domestic pension plan and constitutes more than half of its real estate holdings. Burroughs hired Coldwell Banker Management Corp. to value the property on behalf of its pension plan members, Mr. Level said.

The purchase of the corporation's facilities marks the fund's first large, direct real estate investment. Previously, the Burroughs plan had real estate investments primarily in pooled funds. However, direct real estate investments have been an increasingly popular investment among many larger pension funds.

Burroughs, a manufacturer of computers and information systems, did not file the sale and lease-back with the Labor Department, because the deal was structured within the legal requirements of the Employee Retirement Income Security Act, Mr. Level said.

Although unusual, this type of transaction is not unique. The Boise Cascade Corp. recently raised cash through the sale of timber tracts to its fund and is leasing them back (*Pensions & Investment Age*, March 21). In a slightly different transaction, Diamond-Shamrock Corp. placed one of its royalty interests in the pension fund in lieu of part of its cash contribution (*P&I Age*, April 18).

Burroughs' sale of manufacturing facilities to its pension fund in 1981 and 1982 apparently fits into an overall effort to raise cash and reduce debt, which reached a peak of $1.2 billion in 1981.

According to its 1982 annual report, "net positive cash generated from operations enabled the company to reduce debt during 1982 by $233 million, resulting in a year-end debt balance of approximately $1 billion." By the end of the first quarter, debt had declined another $100 million, to $900 million.

Mr. Level said another benefit to the company is that it is assured continued use of the assets because it holds the option to buy back the

Continued on page 34

Reynolds Metals dedicates

In 2nd cash-saving bid, company puts half fund assets in dedicated portfolio

By Ivy Schmerken

RICHMOND, Va.—Reynolds Metals Co. put half of its pension fund assets in a dedicated bond portfolio in 1982.

The fund dedicated $375 million of its $750 million pension fund by pooling assets from several investment managers and terminated two international advisers to do so.

The aluminum company, which at its April 20 annual meeting reported a 1983 first-quarter loss of $52.6 million compared with $13.6 million a year ago, dedicated last December.

Dedicated bond portfolios match income and maturity payments with pension fund payouts, reducing reinvestment risk and locking in a return. Because of that, actuaries have often allowed dedicated portfolios to justify an increase in the assumed investment income earned on the dedicated plan assets, decreasing the required contribution.

Reynolds' pension expense was reduced by about $39 million "as a result of changes in the assumed rate of return from 7.5% to 9% and the establishment of dedicated bond portfolios which will yield significantly higher rates of return than previously assumed," the firm's 1982 annual report states (*Pensions & Investment Age*, April 18). The company also reduced pension expense by changing its actuarial cost method from entry age normal cost to unit credit cost.

The dedication was the company's second cash-saving strategy involving its pension fund in 1982.

Earlier in the year, Reynolds Metals contributed 600,000 shares of convertible preferred stock to its pension fund in lieu of $30 million cash.

The aluminum company joined other cash-strapped companies—Aluminum Co. of America, Wheeling-Pittsburgh Steel Corp. and U.S. Steel—that issued convertible preferred stock to meet their 1982 pension contribution needs.

A Reynolds spokesman declined to comment on the strategy used by the company to construct the dedicated portfolios.

Industry sources said the strategy involved bond swaps, arbitrage and substitutions.

The spokesman did say Reynolds considered using convertible preferred stock in place of bonds for the dedicated portfolios.

The convertible preferred shares

Continued on page 34

Pension plans cornerstone in Pittsburgh development

By Linda Savage Ruhe and Mark Westerbeck

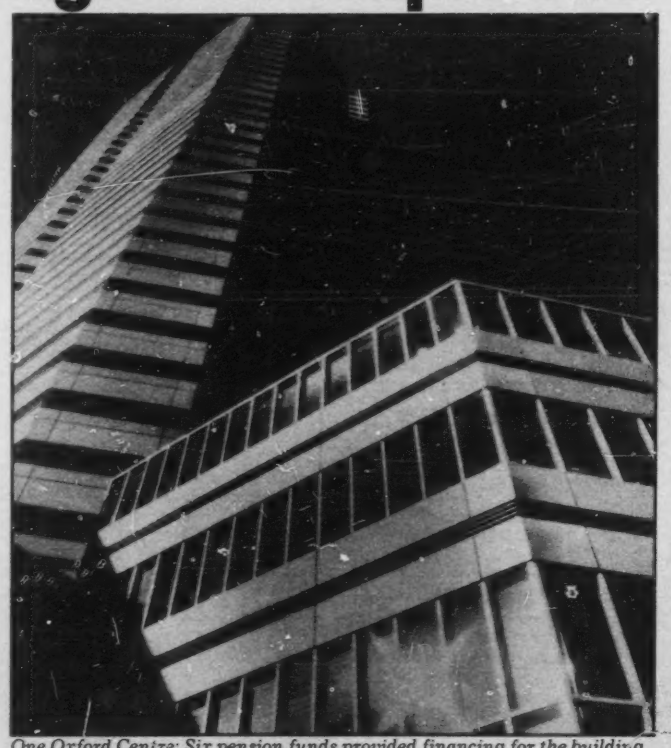
PITTSBURGH—Several pension funds have played major roles in the financing of two new office buildings here.

Six pension funds, including the Pennsylvania Public School Employees Retirement System and the Teacher Retirement System of Texas, financed the recently completed 47-story One Oxford Centre through a participating mortgage arranged by the real estate investment advisory unit of The Boston Co.

Nearby at One Mellon Bank Center, four public funds, an investment adviser representing several public funds and four insurance companies put up $285 million to finance the mortgage on that 54-story office building.

The Oxford Centre investment is treated as a $140 million first mortgage through which the pension funds receive 50% of the cash flow, said Robert A. Radloff, president of The Boston Co. Real Estate Counsel. The mortgage has a 30-year term with a call option between the 10th and 20th years. The funds can sell and receive 50% of the sales price beyond $140 million. Mr. Radloff said Landauer Associates

Continued on page 35



One Oxford Centre: Six pension funds provided financing for the building

PI
DC2001◆STALR FMPJ M
STATISTICAL REFERENCE INDEX
4520 EAST-WEST HWY SU 800
WASHINGTON DC 2001◆

Bond fund's '82 return: 46.7%

Despite restrictions, size, California returns "fabulous"

By Steve Hemmerick

LOS ANGELES—The internally managed $18.7 billion California Public Employees Retirement System has outperformed most of the nation's pension funds in the past two years, despite severe investment restrictions.

Sid McCausland, interim chief of investments, told the fund's board that the system's bond fund had a 1982 return of 46.7%, putting it in the top 1% of the bond fund universe of A.G. Becker's Funds Evaluations Service. The average return for bond funds for 1982 was 29.3% in that universe, Mr. McCausland said.

For 1982, the retirement system also bested the 43.7% return of the Salomon High Grade Bonds and the 31.1% return of the Lehman Bros. Kuhn Loeb Government/Corporate Bond Index.

For the two years ending December 1982, the fund scored a 22.6% return, putting it in the top 5% of bond funds in the universe. The median in the universe for two years was 17.8%.

Although the retirement system's stock portfolio didn't have as good a return compared with its bond portfolio, the stock return still was better than the majority of other returns in the Becker Universe, and it beat the Standard & Poor's 500 index for 1982. The return on equities for the California fund was 26.4%, putting it just slightly below the first quartile for the Becker Universe.

Of the $18.7 billion in the retirement system, 44.6% of the assets are in bonds, 32.4% are in mortgages and equity real estate, 19.8% are in stocks and the remainder in short-term investments.

For the two-year period, the stock portfolio returned 9.7%, beating the S&P 500's 7.3%; and for three years, the retirement system's stock return was 15.1%, equaling the S&P 500's return.

The system doesn't have three-year returns on bonds. It first began using the Becker performance evaluation service three years ago, and only the stock portfolio was measured in the first year.

The retirement system's stock return is especially surprising as it can't invest in many of the S&P 500 stocks because of investment restrictions. State voters last fall defeated an effort by the system to ease those restrictions. Until the system's April 20 board meeting, performance results had been difficult to obtain.

In addition to the restrictions, the fund is hampered by size. Its billions of dollars in investments makes it difficult for the in-house managers to move the portfolio in, out and around the markets. Many other public funds have excused relatively poor performance when measured against corporate funds by saying they are much larger and have many more restrictions.

Robert F. Carlson, president of the system's board of trustees, and a member of the investment committee called the investment results "outstanding" and "great."

Another member of the investment committee and a trustee, Mel Rubin, said the returns were "just fabulous."

Mr. McCausland said it is past investment decisions, criticized at the time they were made, that are "paying off handsomely."

"During 1981, this board allowed us to invest heavily into deep discount bonds at a time when the investment community at large had turned its back on the bond market," Mr. McCausland said. "We took a great deal of criticism at the

Continued on page 31

Two funds win $180 million fight

SACRAMENTO, Calif.—The California public employees and teachers funds do not have to return $180 million in state pension contributions.

The State Supreme Court has declined to hear an emergency motion by the state finance director seeking the return of the contributions because of California's financial difficulties.

The case, involving cash contributions and state government, could be precedent-setting. According to Carl Blechinger, executive officer for the $18.7 billion Public Employees Retirement System, the case was "being watched by states all over the nation. Other state administrations have indicated a distinct interest in it."

In 1982, the Legislature passed a bill withholding one quarter's contributions, about $180 million, from the two retirement systems, saying the state needed the money and the retirement systems didn't.

The legislators involved said the state could get the money out of the retirement systems' reserve fund. Some of them contended the amount set aside for deficiencies—$1 billion—was too large.

But public employee and teacher unions filed suit for the contribution, and an appeals court agreed with the unions' position.

State Controller Ken Cory had placed the money in a special account, and when the court ruled in the unions' favor, he turned it over to the retirement systems immediately.

But Russell Iungerich, attorney for the state director of finance, accused Mr. Cory of "jumping the gun." Mr. Iungerich filed an emergency motion with the California Supreme Court.

The state director of finance wanted the money back before some notes came due on $850 million the state had borrowed because of budgetary problems.

Ben Allamano, chief counsel for the public employees' union, filed an answer to the state's emergency motion with the Supreme Court. Mr. Allamano said of the state, "It looks like to me they (the state officials) are strongly in need of the money and that is their primary interest. I don't think they are worried about the issues of law involved in the case."

In the state's view, the $1 billion reserve the retirement funds had been building was too large and some of that money should have been distributed to the employer/employee accounts to bring down the size of the state's contributions, Mr. Iungerich said.

He said the contribution rates were artificially high because the retirement systems weren't distributing that reserve money, and he claimed some of the reserve money was "lost to the system" for more cost-of-living allowance benefits for the retirees.

Continued on page 32

Late news

Continued from page 1

Breen leaves Sarofim

HOUSTON—Daniel A. Breen resigned as president of Fayez Sarofim & Co.

Fayez Sarofim, chairman of the board, will resume the presidency. Mr. Sarofim said the "parting is amicable" and that Mr. Breen decided to leave for personal reasons. Mr. Breen had come under fire in the wake of news that the firm's performance had been dismal during the past few years (*Pensions & Investment Age*, March 21). But Mr. Sarofim said "I don't know what triggered the decision."

Fund may unite firms

DALLAS—A group of former Braniff International Corp. employees are hoping to use Braniff's pilots' pension fund to help bring the airline and Hyatt Corp. together. Officials of the bankrupt airline had rejected a rescue attempt made by Hyatt on the ground it was at least $10 million short of what they considered to be minimum capitalization. The former employees have offered to raise that $10 million, suggesting some or all of it could come from the pilots' plan.

PBGC vs. Teamsters

JACKSON, Miss.—The $3.7 billion Central States Teamsters Pension Fund and the American Trucking Associations Inc. are engaged in a "friendly lawsuit" with the intent of overturning the withdrawal liability provisions of the multiemployer pension law, a government agency has charged.

In papers filed in U.S. District Court here April 15, the Pension Benefit Guaranty Corp. argues the Central States fund and the trade group have discussed legal strategy for the case and have shared information with each other throughout the litigation, even though they are on opposite sides of a suit challenging the law.

DOL sets guidelines

WASHINGTON—The Department of Labor has developed guidelines for how it will respond to corporate mergers and tender offers involving use of employee benefit plan assets. In addition, the department has created an internal structure to respond swiftly to tender offer situations. The guidelines are to be released shortly.

Connecticut appoints

HARTFORD, Conn.—The $1 billion State of Connecticut Mutual Fixed Income Fund, part of the $2.4 billion State of Connecticut Trust Funds, has awarded Lehman Management Co. $80 million and Financial Management Group $20 million, both for active bond portfolios.

P.I.P.E.R. results in

NEW YORK—Pooled equity funds of banks and insurance companies chalked up a 9.5% time-weighted return in the first quarter of this year, according to the Pensions and Investments' Performance Evaluation Report. This is slightly below the Standard & Poor's 500 index figure of 10% for the same time. For the year ending March 31, the median equity fund had a 42.2% rate of return, compared to 44.5% for the S&P 500.

On the bond side, the median return was 3.1% for the first quarter and 29.2% for the year ending March 31. This compares to Salomon Bros. High Grade Bond Index's first quarter return of 3.7%, and the year's return of 43.9%.

TUCS beat S&P 500

SAN FRANCISCO—The median equity manager in the Trust Universe Comparison Service slightly outperformed the Standard & Poor's 500 index, 10.14% vs. 10%, in the first quarter of this year.

The median result for the bond manager in the TUCS universe was 2.6%, falling behind the 3.2% first-quarter return for the Lehman Bros. Kuhn Loeb Government/Corporate Bond Index. For the first quarter, cash managers had a 2.6% return and balanced managers had a return of 6.6%. For the 12 months ending March of this year, equity managers had a 44.1% return, vs. 43.8% for the S&P 500, and fixed-income managers had a 12-month return of 26.8%, vs. 30.6% for the Lehman index.

Equity adviser added

CINCINNATI—Cincinnati Bell has hired Renaissance Investment Management in Cincinnati as an additional manager. Renaissance will run an equity portfolio for the $225 million pension fund initially totaling $5 million.

Gregg, McKay named

BALTIMORE—Gregg, McKay, Knight & McKay was added to the State of Maryland Retirement Systems' list of 10 new equity managers who will receive $445 million to manage. Gregg, McKay joins the ranks of specialty growth stock managers. The firm will be given $15 million, he said.

Highlights

CORPORATE FINANCE Page

Risk evaluation, debt defaults and premiums ... 27
Thrifts eye corporate loan business ... 27
Paine Webber finds its niche ... 27

DAN DORFMAN

Yardeni sees energy stock slump ... 8

FEATURES

Profiting from profit-sharing: Metzger ... 23
A national market for real estate: Pritchett ... 24

GENERAL NEWS

First Pacific drops Los Angeles City fund ... 6
Dan River to terminate defined benefit plans ... 9
DLJ, L.A. County accord ... 12
In-house funds lag first quarter indices ... 13
University protests South Africa law ... 19
DOL's proposal exempts pooled vehicles ... 20
Russell switches international managers ... 20
Pennsylvania agency targets investment ... 21
Court backs company on excess assets ... 26

REAL ESTATE

Doubts cast on realty use of IRR ... 15
Real estate wrap-up ... 15
MGIC securities safe from parent's problems ... 16

OTHER DEPARTMENTS

Accounts moved ... 38
Classifieds ... 37
Corrections ... 8
Editorials ... 10
Letters ... 10
Money movers ... 38
People ... 30
Washington ... 25

Vol. 11, No. 9—Pensions & Investment Age (ISSN 0273-5466) is published every other Monday at 740 Rush St., Chicago, Ill. 60611. Second class postage paid at Chicago, Ill. and at additional mailing offices. Postmaster: Send address changes to Pensions & Investment Age, Circulation Dept. 740 Rush St., Chicago, Ill. 60611. Copyright 1983.

$3 million in foreign stock

Idaho investment stirs question of disclosure

By Ivy Schmerken

BOISE, Idaho—The $600 million Idaho Public Employee Retirement System became one of the few public funds with international investments when it placed $3 million in an international equity fund.

The investment was made, however, apparently without the board of trustees' knowledge. Because the fund operates under the prudent man rule and managers have full discretion, the manager who made the investment did not need specific approval.

But retirement board Chairman Alan Jensen said, "as a general rule, I would expect any manager of ours to touch base with the board or the administration before he did anything innovative."

According to one source, the investment was not disclosed to the board because it might have caused a political stir.

However, both the adviser who recommended the investment and the trustee bank say they believed there was no need to inform the board of the investment because of their discretionary powers and because the investment was such a small one relative to the size of the fund.

Continued on page 35

Features

Profiting from profit-sharing

Defined contribution plans offer more—not less—protection

By Bert L. Metzger

ARE DEFINED benefit plans doomed? *Pensions & Investment Age* in its Dec. 20, 1982, issue suggested they were. However, any prediction about the demise of defined benefit pensions is premature.

Such plans satisfy distinct needs, particularly for people with long past service who are up in years when the retirement income plan is initiated, people whose earnings rise rapidly in the years immediately preceding their retirement, high-paid executives and employees who like the sense of security conveyed by the promise of fixed benefits relayed to final pay.

Immediately subsequent to the Employee Retirement Income Security Act of 1974, defined benefit pension plan approvals fell significantly, but they have rebounded well and have demonstrated considerable strength. See Tables I and II.

Numerically, more profit-sharing programs were initiated in the 5¾ years from 1977 through Sept. 30, 1982 than any other type of retirement-income plan. Nevertheless, defined benefit pensions moved steadily forward after a slow post-ERISA start. In 1977, for example, only 6,953 defined benefit pensions were approved compared with 10,113 money-purchase pensions. During the first nine months of 1982, 22,102 defined benefit pensions were implemented compared with 18,273 money-purchase pensions.

Defined benefit pensions accounted for only 26% of new plans, but 62% of participants in new plans; money-purchase pensions, with 29% of new plans, covered only 10% of new participants; and profit-sharing, with 45% of new plans, accounted for 28% of new participants.

Defined benefit plans represented 28% of the plans in the universe in the summer of 1975, defined contribution plans 72%.

In 1977 and 1978, defined contribution plans soared to between 80% and 85% of approvals but dropped back into the historical range of 71% to 73% during 1979 to 1981.

In short, the approval rate for all types of retirement income programs is at a record level. Profit-sharing and defined benefit plans are leading the way.

Many large companies with pensions today do not want to enrich their pensions further, with unpredictable cost implications particularly in periods of high inflation. Meeting pension commitments during a recession has proved to be a heavy burden for many companies. Firms in this category are supplementing their pensions with profit-sharing or thrift plans, frequently 401(k) plans.

Other companies have started with profit-sharing as their sole retirement income plan, aside from Social Security, but are adding complementary pensions, such as "wrap-around" pensions covering service not included under the profit-sharing plan, "floor" pensions and the like.

The *P&I Age* editorial said "employees are the losers where defined contribution plans replace defined benefit plans." If this is so, it occurs principally because little benefit accrues in a young person's pension in early years. Age largely determines the amount of the annual accrual in a pension. Accruals are skewed to older workers nearing retirement.

Ten-year "cliff" vesting in pensions might aggravate further the problem for the middle-age and younger employee. If the employee's participation is terminated before 10 years of service, he might get nothing from his pension plan.

Under profit sharing, individual account buildups occur more rapidly for younger employees and faster vesting makes possible a more meaningful portable benefit in our highly mobile society. Vesting in profit sharing is normally graduated starting at one to three years of service and rising by 10% increments to 100% after 10 to 11 years of service.

According to a Bankers Trust Co. study, 10-year "cliff" vesting is used by all pattern (negotiated) pension plans, and by nine out of 10 conventional pension plans.

Graduated vesting gives the employee an annual incentive to stay with the company and this tends to reduce employee turnover.

The whole country would suffer if there were a major shift from defined benefit to defined contribution plans, according to the *P&I Age* editorial. Why? The editorial explains:

- "The national savings rate probably would drop, reducing the amount of money available for capital investment."
- "... since defined contribution plans offer less retirement protection than defined benefit plans, the burden on the Social Security system will be increased at a time when the system cannot bear it."

It is difficult to see why the national savings rate would drop. Most pension plans are non-contributory (eight out of 10 according to a recent Bankers Trust Co. study), while more than 60% of deferred profit-sharing plans are contributory.

Employees may participate on a voluntary basis in the thrift incentive feature of the profit-sharing plan and this adds 3% to 6% of pay or more to their capital accumulations. This will take on even greater significance as 401(k) salary reduction agreements encourage higher employee participation and the initiation of more plans.

Company payments to defined contribution plans as a percentage of pay of participants are comparable to or slightly higher than those made to defined benefit plans. Companies usually contribute between 6% to 9% of pay to their pension programs while employers normally contribute an amount equivalent to 9% to 10% of pay to their profit-sharing programs.

Under the circumstances, a switch to defined contribution plans would likely increase the national savings rate and make more money available for capital investment. Thus, defined contribution plans may well offer more, rather than less, retirement protection.

During the recession, many employees became aware that the guarantees under defined benefit pensions were not absolute and neither a company "on the ropes" nor the Pension Benefit Guaranty Corp. will be able to provide 100% of the benefits accrued. Defined contribution plans do not make for instant security but they do emphasize two concepts: profitability and affordability.

The best security is earned security; profit sharing, relating contributions to corporate performance, highlights this. Individual vested accounts in the profit-sharing trust convey a sense of ownership and security to participants.

Further, retirees under defined benefit plans have only a promise of fixed dollars per month during retirement. These payments surely will be eroded by inflation. Only management goodwill and ad hoc adjustments will help the retirees partially keep up with inflation.

Profit-sharing distributions may be taken in a lump sum in cash and/or company stock "in kind" or through installments with the balance participating in investment returns through the years. How might this latter work out in practice?

A participant who retired with $60,000 in a fixed-income fund and who elected to receive 15 annual installments would receive $4,000 as his first installment (1/15 of $60,000). Under an assumption of an annual yield of 9% credited to his unpaid balance and the retiree receiving 1/15, 1/14, 1/13, etc. of his revalued account each year, he would realize an increasing amount from interest and principal each year.

The fifteenth and final installment would be approximately $13,364. The total settlement would have yielded the retiree more than $116,000.

Individuals also would have additional options. The retirees could withdraw less of the interest and principal each year and stretch the installments out for a longer period, such as the joint life expectancies of the retirees and their spouses.

In other words, profit sharing permits the retiree's unpaid balance to continue to participate in investment returns, and the power of compound interest continues to directly benefit the retiree. Is this not a fair measure of retirement protection?

A distribution in a lump sum in cash can provide the recipient with great flexibility, rollover options and investment income during his retirement years.

Many large companies have a substantial portion of their profit-sharing funds in-

Continued on next page

Bert L. Metzger is president of Profit Sharing Research Foundation, Evanston, Ill.

Table 1

Number of Newly Approved Profit-Sharing and Pension Plans and Participants 1977-1982

Excluding Stock Bonus, ESOPs, TRAESOPs, Bond Purchase, and Target Benefit Plans

PLAN TYPE	PLAN APPROVALS		PARTICIPANTS	
	NUMBER	PERCENT OF TOTAL	NUMBER	PERCENT OF TOTAL
•Profit sharing	165,902	45	3,749,869	28
•Money purchase	108,656	29	1,358,773	10
•Defined benefit	97,176	26	8,376,835	62
Total	371,734	100	13,485,477	100

Table 2

Defined Contribution Plans (Profit Sharing, Stock Bonus and Money Purchase Pensions) and Defined Benefit Plans

Numerical Breakdown According to EBS-1 Data, Summer 1975, and Subsequent IRS Reports

NEW PLAN APPROVALS	DEFINED CONTRIBUTION PLANS	DEFINED BENEFIT PLANS
Summer 1975	72%	28%
1977	80	20
1978	85	15
1979	72	28
1980	73	27
1981	71	29
1982 First nine months only	68	32

BEST AVAILABLE COPY